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E.O. 12958: DECL: 05/21/2027
TAGS: EFIN PREL HU
SUBJECT: VERES: REFORMS ON TRACK

REF: BUDAPEST 781

Classified By: Economic Officer based upon E.O. 12958, reasons 1.4 (b) and (d)

¶1. (C) Summary: In a brief May 16 meeting to discuss the recently released International Monetary Fund (IMF) Report on Hungary (Ref), Finance Minister Veres expressed confidence in ongoing reforms, noting the successful, quiet (without prompting any of the recent demonstrations or other strong grass roots opposition) implementation of a series of reforms. He downplayed most of the most serious IMF concerns, arguing that Hungary can and will make spending cuts that will yield macroeconomic improvement, but that cutting expenditures all the way down to the IMF-preferred level would take ten years. Avoiding any mention of a target date for euro adoption, Veres nevertheless appeared comfortable in his assessment of robust tax revenues and declining deficit and debt projections. He anticipates sweeping tax reforms that could be implemented as soon as in 2008, but cautions that the government must cut expenditures first. One step he sees as essential is the creation of a Congressional Budget Office-like body in Hungary, which he expects to be enacted into law this year. End Summary.

Success - the Veres View

¶2. (C) Veres listed reforms that have already been successfully implemented: reduction of the natural gas subsidy for home heating, modified pharmacy pricing system with greater avalability of over-the-counter drugs, co-payments for doctor visits, introductionof a modest higher education tuition fee, adding an extra 2 hours instructional time for elementary and secondary teachers each week, and an over 17,000 reduction in the government work force. Drawing an apparent contrast to political unrest and demonstrations over the past year, Veres added through his translator: "We did all of this. No demonstrations, nothing." He said certain reforms would continue as planned: increasing restrictions on early retirement, transforming the disability system to increase workforce participation, and further energy price subsidy reductions (primarily through limiting the number of beneficiaries).

¶3. (C) Despite these reforms, Veres acknowledged some ongoing challenges, notably the lack of a Constitutionally required two-thirds Parliamentary majority to reduce the number of local governments. The government has already built the failure of some reforms to pass into their projections, so this should not affect deficit targets. However, he clearly chose to highlight as success two key

figures: consistent nearly-adequate tax receipts and the shrinking budget deficit. On the budget, he said that every annual target on the way from 9.2 to 3.02 per cent "can be met," noting that the government has already revised the 2007 deficit target down from 6.8 to 6.6 per cent, and expressing his agreement with analyst views that it would be closer to 6.4 per cent.

Sidestepping Criticism: Health Care and Public-Private Partnerships

¶4. (C) Veres sidestepped the intense public intra-coalition debate on health reform between MSZP and SZDSZ, noting that the general budget target for health care is agreed upon, so that further discussion on the specifics, such as single payer or multi-payer insurance plans, while interesting and a sensitive topic, would not affect the budget targets. SZDSZ chief/Economic Minister Koka has told us that he fears that the political debate is becoming the story, rather than the merits of the health care issue. That said, political analysts tend to agree with Veres, the budgetary targets are set and the question is how to divide the pie, not how big it will be. On Public-Private Partnerships (PPPs), Veres took a similar approach, saying that the budget already includes the government annual required contribution ("availability payments") and that PPP debt has a minimal impact on national outstanding debt. According to Veres, the IMF possibly "didn't understand" what Hungary was doing in these areas, because he could find no basis for their criticism. This discussion prompted an offer for a working-level follow-up meeting for a more precise exploration of these elements of the report - an implicit acknowledgement that these perennial issues are not so simple.

Looking Ahead: Competition, Revenue, Expenditures, Oversight

¶5. (C) Veres readily discussed differences between Hungary and its economically booming neighboring country, Slovakia. He discounted conventional wisdom that low and simple taxes alone played the key role in Slovak competitiveness, instead asserting that low public expenditure levels made lower taxes possible. Applying this to Hungary, the IMF lower target of government expenditures as forty per cent of GDP is simply unrealistic. Rather, lowering expenditures down from fifty per cent to forty-six percent is more likely. In this context, Veres supports tax reform, but only after the government seriously cuts expenditures. In order to keep the budget process honest, Veres strongly favors an office modeled after the U.S. Congressional Budget Office to provide a clear picture of expenditures. Looking ahead, then, he sees the current trend of lowering the government debt as share of GDP to continue because of robust revenue streams and declining fiscal deficit. He hopes that most of the reforms will be completely enacted within one or two years, and sees tax reform as something that can and will enhance competitiveness in the years to come.
LARSON